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FM AMEMBASSY ANKARA
TO RUEHC/SECSTATE WASHDC 6180
INFO RUCPDOG/USDOC WASHDC
RHEBAAA/DEPT OF ENERGY WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHDC
RUEHZL/EUROPEAN POLITICAL COLLECTIVE
RUEHIT/AMCONSUL ISTANBUL 4190
RUEHDA/AMCONSUL ADANA 2907

UNCLAS SECTION 01 OF 02 ANKARA 000862

USDOE FOR CHARLES WASHINGTON
USDOC FOR 4212/ITA/MAC/CPD/CRUSNAK

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: [ENRG](#) [EPET](#) [EINV](#) [TU](#)
SUBJECT: Turkey Re-launches Privatization of Electricity
Distribution Companies

REF: A) Ankara 00001
B) 07 Ankara 00676

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Sensitive But Unclassified. Please handle accordingly.

11. (SBU) Summary and comment. On April 28, the Privatization Agency (PA) announced that the GOT's long-delayed privatization of electricity distribution companies would re-start. Privatization was delayed in January 2007 to avoid raising electricity prices prior to July 2007 parliamentary elections. The process will pick up roughly where it left off. Two of the three previously tendered electricity distribution companies -- Baskent Electricity and Sakarya Electricity -- are on offer. Serious Turkish and international investors, including American companies, who had already cleared the earlier pre-qualification stage, are invited to submit bids by June 10. The GOT has also announced a second phase of privatization for Meram and Aras electricity distribution companies. Pre-qualification bids are due May 26. For investors, the risks associated with state-controlled tariffs were eased by recent tariff increases, but the value of these privatizations depends heavily on whether the GOT allows a long-awaited automatic price adjusting mechanism for electricity to go into effect in July, a month after bids on the first round of privatizations are due. Investors also had hoped to be able to bid simultaneously on distribution and generation assets, and Energy Minister Guler had told us that the two would go forward together (reftel A). However, the PA did not mention state-owned generating assets when it announced these four distribution tenders. End summary and comment.

Privatization Strategy

12. (U) According to the original privatization strategy announced by the PA in August 2006, the GOT aims to privatize 20 of 21 regional electricity distribution companies and disband TEDAS, the state monopoly distribution company, which now has 28 million customers, 93 billion kWh worth of electricity sales and controls 98 percent of Turkey's electricity distribution. Under this model, winners of the tenders will not acquire TEDAS's assets. Instead, they will "own" only the operating rights to the distribution networks.

First Round: Choice Assets but Excludes Istanbul

13. (SBU) In the first round, the PA has decided to re-start the privatization process where it left off in January 2007, with one major exception. This time the PA has canceled the tender for the Asian side of Istanbul, one of the most attractive assets. However,

Baskent Electricity and Sakarya Electricity, which were offered previously, are still very attractive to investors. The two companies' regions are contiguous, making bids on both companies to gain economies of scale a possibility.

¶4. (SBU) Baskent Electricity is one of the jewels of Turkey's electricity distribution networks. Outside of Istanbul's regional electricity company, it has the largest customer base (2.8 million), distributes almost 10 percent of Turkey's total electricity to seven cities. Its technical and non-technical losses (i.e. theft and non-payment) stand at 10 percent, which is low for Turkey. Sakarya Electricity covers four cities in the industrial heartland in Western Turkey. Its customer base is 1.3 million and its losses are also 10 percent.

¶5. (U) Prominent Turkish holding companies, including Dogan, Sabanci, Enka, Zorlu, Gama and Calik, have been pre-qualified for the tender. Three U.S.-owned companies -- AES Amsterdam Holdings B.V., Prisma Energy Global Services Ltd, and General Electric -- are expected to bid for the tender, together with Turkish partners. Other foreign companies interested include EnBW Energie Baden-Wurttemberg AG, EON Energie AG, Iberdola S.A., Novosibirskenergo Energy, and Suez-Tractabel Energy Inc.

Second Round Announced

¶6. (SBU) On May 2, the PA announced that the privatization process for Meram and Aras electricity distribution regions would begin on May 5. These two companies will be offered for the first time and interested bidders will need to apply for prequalification by May 26, with a bidding deadline of July 15. Meram is likely to be much more attractive than Aras. Meram includes the central Anatolian cities of Kirsehir, Nevsehir, Nigde, Aksaray, Konya and Karaman. It distributes five percent of Turkey's total electricity and enjoys low levels of losses, approximately eight percent. Meram also is contiguous with the Baskent electricity distribution company, making

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it potentially attractive to the winner of that bid. Aras distribution company is located in Eastern Turkey and includes the cities of Erzurum, Agri, Ardahan, Erzincan, Igdir and Kars. Aras. The investment requirements in Turkey's East are high and the total losses at Aras are almost 30 percent.

Investment Risk Tied to Tariffs

¶7. (SBU) Comment: These will be attractive privatizations, but with substantial regulatory and political risk. Turkey's regulated electricity prices are some of the lowest in this region. Average retail price is about 8 kurus (Turkish cents) per kilowatt hour, while wholesale prices can be up to 18 kurus. (Note: USD 1.00 = Turkish Lira 1.25) In this formulation, either the government ends up subsidizing the difference (which it is unlikely to do for a private entity) or the company loses money. Electricity tariffs were frozen from 2002 until January this year, when the GOT allowed increases of 10 percent for industrial users and 15 percent for residential customers. Still, tariffs remain regulated and tariff increases are political decisions. In February 2008, the Higher Planning Board promulgated a ruling to introduce an automatic, cost-based tariff formula that would take electricity rate decisions away from political officials. However, the ruling did not include an implementation date. This decision is left to the Minister of Energy who has said implementation will begin in July 2008. This new pricing mechanism could sharply increase the value of these privatizations. However, bidders on the first round of privatizations will have to bid without knowing if the automatic pricing mechanism will be allowed to go into effect.